Are Oil Stocks Oversold?

Description

WTI oil continues to slide and is now below US$100 per barrel. Canadian energy stocks are falling as a result, and investors who missed the big rally off the 2020 lows are wondering if oil and gas stocks are now undervalued and good to buy.

Oil market outlook

WTI oil trades for US$96 per barrel at the time of writing. That's down from more than US$120 it topped twice this year. Traders are trying to figure out if a potential recession in 2023 or 2024 will hit demand enough to offset supply shortages.

Most economists put the chance of recession in Canada and the United States at 50% or lower in recent reports. The global picture is mixed with some regions, like Europe, viewed as more likely to see a downturn.

Chinese oil demand, however, is expected to surge, as COVID-19 lockdown orders that were in place in recent months get lifted. Oil demand, overall, is expected to continue to rise in the next few years, even amid an economic slowdown.

On the supply side, there is little evidence that a surge in new output is on the way to drive down oil prices. The global energy industry cut investments by hundreds of billions of dollars over the past two years due to the crash. This means new output that would have come online is not imminent. OPEC is struggling to meet its scheduled supply increases, while Canadian and U.S. producers are using excess cash to buy back stock and reward investors instead of channeling the money into exploration and higher production.

Restrictions or sanctions on the sale of Russian oil could also reduce supply in the coming months. At the same time, ongoing operational and political challenges in a handful of other key producing countries continue to limit the industry's ability to add new supply.

Regardless of the economic outlook, employers are calling commuters back to the office and airlines are planning to add more routes when they get staff levels to the point where they can handle the surge in travel demand. Oil demand is already high. The surge in fuel consumption will push it up even more through the end of this year and into 2023, as gasoline and jet fuel demand increase.

Should you buy oil stocks now?

Canadian energy stocks could see more downside in the near term due to volatility in the oil market, but the pullback appears overdone.

Suncor (TSX:SU)(NYSE:SU), for example, trades near $41 per share at the time of writing. It was $44 per share in early 2020 before the pandemic when WTI oil was US$60 per barrel. Dividend increases have pushed the payout to an all-time high and the company is rapidly reducing debt and buying back up to 10% of the outstanding stock. Suncor's refineries are running near capacity and the retail operations are expected to get even busier. Even if WTI oil settles in a range of US$80-US$90 per barrel, Suncor stock looks undervalued.

Oil could easily take a run back to the US$120 mark on positive economic news or new supply shocks. If you have some cash to put to work, energy stocks deserve to be on your radar right now.

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